BEFORE THE STATE OF WASHINGTON
ENERGY FACILITY SITE EVALUATION COUNCIL

In the Matter of Application No. 99-1:

SUMAS ENERGY 2 GENERATION FACILITY

EXHIBIT ____ (RK-RT)

APPLICANT'S PRE-FILED REBUTTAL TESTIMONY

WITNESS: RICHARD KEEFE

Q. Please re-introduce yourself to the Council.

A. My name is Richard Keefe. I'm an investment banker with Macquarie Corporate Finance in New York. I assist clients with the sale, purchase and financing of energy facilities.

Q. What issues will your rebuttal testimony address?

A. I will address the financial implications of the greenhouse gas offset proposals being advocated by some parties in these proceedings. In particular, I have reviewed the testimony submitted by Richard Gammon on behalf of the "Counsel for the

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Environment" and the testimony submitted by Nancy Hirsh, K.C. Golden and Peter West on behalf of the Northwest Energy Coalition, and will respond to portions of that testimony.

Q. Based on your review of the testimony, what do you understand the witnesses for the Council for the Environment and the Northwest Energy Coalition to be recommending?

A. As I understand from their testimony, these witnesses believe that the Siting Council should require the developers of the SE2 project to provide up-front funding to "fully offset" the greenhouse gas emissions that would be associated with operating that facility at 100% capacity for a 30-year period. Mr. West calculates the annual emissions (assuming 100% capacity) to be 2.42 million tons. The witnesses then vary in their assessment of the price of offsets. Mr. West says $1.88 per ton, Ms. Hirsh says $2 per ton, and Mr. Golden says $5 per ton. Mr. West also contends that the developer should pay an additional 5-10% to cover administrative costs.

Q. How much would it cost to provide the so-called "full offset" that they have recommended?

A. Using their assumptions, just doing the math, it would cost between about 135 million dollars and 363 million dollars, plus the 5-10% administrative costs, which brings the total in the range of 140-400 million dollars.

Q. In your professional opinion, would anyone build this project if that sort of mitigation requirement were attached?

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A. An increase of $140-400 million in cost without a commensurate revenue increase would be a huge disadvantage that, in my opinion, would make it extremely unlikely that the project could be financed. Such an increase would represent an approximately 30-80% increase in project cost. This would be a huge disadvantage in an increasingly competitive market.

Another way to examine the impact on investment decision that such a cost increase could have would be to calculate the necessary increase in revenue that would be needed to maintain the Internal Rate of Return (IRR) of the project investors – the return on capital that the investors receive after payment of all expenses, etc. This would require making some assumptions. For example:

Capacity	660 MW
Capacity Factor	82.5%
Debt/Equity Ratio	50/50
Debt Term	20 yrs
Debt Rate	9%
Equity IRR	17%
Equity Horizon	30 yrs
Offset Cost	$140 million - $400 million

On these assumptions, it would require an approximately $25-71 million per year increase in revenue to maintain investor IRR. This would translate into an approximately 0.53 to 1.51 cent increase in revenue per kilowatt sold. At first impression, this might seem like an insignificant amount, but when compared to the

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current spot price of electricity of 2.5 cents, this would represent a greater than 20% increase at the lower end of the range, and almost 60% at the upper end, in cost to be passed on to consumers. Again, this would probably be seen as a prohibitively high hurdle for successful financing.

Q. In his testimony, Mr. West argues that a $118 million offset requirement would translate into a what he describes as a "relatively small price impact" per kilowatt hour. How do you respond to his analysis?

A. Even if Mr. West were correct as to his characterization of the magnitude of the economic impact of the required offset (which he is not), his basic premise is flawed. To say that this offset would have a "relatively small price impact per kilowatt hour" misstates how prices will be set in the marketplace. The offset cost will not necessarily have any impact on the price at which the project's electricity is sold, no matter what the magnitude. Energy is sold into a competitive market; it is not a cost-pass-through product. This asset will not be guaranteed a regulated rate of return on its construction cost. The Sumas 2 generating facility will sell its product--electricity--in competition with all other energy producers only at what the competitive market will pay. The project cannot just add costs (mandated or otherwise) to its product and expect its revenue to rise proportionately by passing on such expenses to consumers. Additional costs, from whatever source, will be borne by the equity investors in the project. Extra costs raise the investment threshold.

END OF TESTIMONY

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